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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 369

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LASALLE & KOCH COMPANY,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONERS

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The Government has conceded that the LIFO statute accords taxpayers, including retail method taxpayers such as Macy, a right to elect LIFO for fiscal 1942, but only pursuant to regulations prescribed by the Commissioner.* (See, *e.g.*, Sec. 22(d)(2)(A) of the Code; App. 63-64.) The position of the Government here (GB 9-13) and of the court below (App. 11-12) is, therefore, not only (i) that the original LIFO regulation applied to retail method taxpayers but (ii) that whether or not applicable by its terms, the right to challenge that regulation by such tax-

*As noted by the court below:

". . . Both Macy and the government agree that the statutory right to elect LIFO was not absolute, but was conditioned upon compliance with appropriate regulations to be issued by the Commissioner . . ." (App. 7).

payers was the equivalent of their statutory right to elect LIFO.

Both the Government here and the court below arrive at their conclusion that the original LIFO regulation was applicable to retail method taxpayers by ignoring (i) the rule in *Bowles* v. *Seminole Rock Co.*, 325 U. S. 410, that the meaning of a federal administrative regulation is to be sought in the intention and interpretation of the promulgating administrator, and (ii) the fact that the original LIFO regulation contained an absolute bar to its utilization by retail method taxpayers. Although expressly relied upon in the petition (Pet. 6, 8, 14, 16), the entirety of the Government's brief is built upon an avoidance of that settled rule and that overwhelmingly significant fact.

1. (a) In the petition (Pet. 6, 8, 16), Macy stressed that the original LIFO regulation contained requirements for "matching of goods" which made compliance with that regulation impossible for retail method taxpayers. The requirements for "matching of goods" are found in subdivision 19.22(d)-2 of the original LIFO regulation (App. 69-74). They are couched in terms of specifying with "particularity" the goods to which LIFO may be applied and of computing opening inventories and increases in closing inventories over opening inventories by "units" and "unit costs", language *not* found in the LIFO statute.*

The necessary effect of the Commissioner's incorporation in the original LIFO regulation of requirements for "matching of goods" was affirmatively to bar compliance with the original LIFO regulation by retail method tax-

*It is clear from the opinion below (App. 9, fn. 4) that the court of appeals believed that the LIFO statute contained "similar language" to the phrases "specifying with particularity", "unit costs", and "units" which the Commissioner included in the original LIFO regulation. Neither those phrases, nor similar phrases, are found in the LIFO statute (which simply uses the phrase "goods specified in the application"). Compare App. 63-65 with App. 68-74.

payers. In Paragraph 7 of the Stipulation of Facts (App. 46-47), the Government conceded this fact, *viz.*, that inventorying "in terms of specific goods . . . is not practicable" for retail method taxpayers.

The Government also has omitted discussion of another stipulated fact (App. 55) which shows the inapplicability of the original LIFO regulation to retail method taxpayers —*i.e.*, the Commissioner's 1948 amendment of that regulation. Those amendments, retroactive to 1938, specifically exempt retail method taxpayers from compliance with the "matching of goods" requirements of the original LIFO regulation and are an incontestable acknowledgment that a retail method taxpayer could not have complied with the original LIFO regulation (App. 79-88). Hence, the original LIFO regulation accorded retail method taxpayers only the right "either to acquiesce . . . or . . . challenge it" (GB 12).

By refusing to acknowledge that the original LIFO regulation made election of LIFO by retail method taxpayers impossible, the Government has felt free to suggest that although

> ". . . the Commissioner believed that the [LIFO] statute did not apply [to retail method taxpayers] does not mean that he intended his regulations . . . to foreclose the issue" (GB 9).

Of course, the intention of the Commissioner to "foreclose" or not to "foreclose" the issue is now academic, since he in fact did foreclose it by promulgating the "matching of goods" requirements of the original LIFO regulation. Moreover, it is perfectly clear from the following arguments of the Commissioner to the Tax Court in *Hutzler Brothers Company*, 8 T. C. 14 (1947), that he had intended, in promulgating the original LIFO regulation, to foreclose the election of LIFO by retail method taxpayers:

> ". . . The regulations leave no room for doubt, as authorized by Sections 22(c) and 22(d)(3) of the Code, that there must be a matching of articles of goods on hand at the end of the year with similar articles of goods on hand at the beginning of the year. This is further established by the language used in Section 19.22(d)-2 (2) of Regulations 103, as amended, which requires the petitioner to specify 'with particularity' the goods to which the elective method is to be applied.
>
> ". . .
>
> ". . . That Section [19.22(d)-2] throughout refers to specific units acquired at specific times and at specific prices. In no place does the Commissioner prescribe that the retail method provided in Section 19.22(c)-8 of the Regulations, or any modification thereof, may be used under Section 22(d) of the Code . . ." (*Brief for Respondent*, Docket No. 4083, Tax Court of the United States, pp. 45, 50-51).

As already noted, the Government has stipulated in this case that the "matching of goods" requirements of the original LIFO regulation made that regulation unusable by retail method taxpayers. It cannot be rationally contended that promulgation of a regulation setting a time to elect LIFO subject to compliance with impossible requirements accords to taxpayers barred by those requirements that right to elect LIFO intended by Congress.

(b) The Government also argues that the decision below was correct for a reason neither reached nor discussed by the court below, *i.e.*, that even if the remainder of the original LIFO regulation was inapplicable to retail method taxpayers, the subdivision which required filing on Treasury Form 970 of an election to use LIFO (Regs. 103, Sec. 19.22(d)-3; App. 74-75) was applicable to such taxpayers. That argument is absurd.

The subdivision to which the Government refers expressly required filing Treasury Form 970 "pursuant to the

instructions printed thereon and to the requirements of this section". As noted above, among such requirements were the requirements for "matching of goods" with which retail method taxpayers could not comply. In addition, Treasury Form 970 specifically referred to that subdivision (19.22(d)-2) of the original LIFO regulation which embodied the "matching of goods" requirements. The instructions on the Form required that the taxpayer "specify with particularity the goods" as to which the election is made and that there be attached to the Form "an analysis of all inventories of the taxpayer . . . prepared in detail in accordance with existing regulations". Finally, the Form required an affidavit by the taxpayer that its application for election of LIFO is "made . . . pursuant to the requirements of . . . the regulations".

In an attempt to avoid the plain meaning of the "*Time and Manner of Making Election*" subdivision (19.22(d)-3) of the original LIFO regulation, the Government suggests an ingenious rationale. It suggests that the Commissioner intended by that subdivision to force binding elections between LIFO and FIFO upon all taxpayers, even those whose right to use LIFO he had barred in the remainder of the regulation. The ingenious rationale for this anomalous act is that the Commissioner promulgated the "*Time and Manner of Making Election*" subdivision in order to deprive barred taxpayers of the benefit of hindsight should the Commissioner's interpretation of the LIFO statute, as embodied in the regulation, later be held erroneous. That rationale does not bear analysis. As noted in the petition (Pet. 19 fn.*), the mere filing prior to 1948 of Treasury Form 970 by a retail method taxpayer did not constitute a binding election of LIFO, since until that time it was always open to the taxpayer to acquiesce in the Commissioner's position. Thus, as the district court perceived, (i) it violates every canon of construction to read the "*Time and Manner*

of Making Election" subdivision of the original LIFO regulation "*in vacuuo* and isolated from the other subdivisions" and (ii) it "would be rationally offensive to make provision for the time and manner of the filing of a statement of election by one in whom, it is asserted, the right to make an election does not reside, and to whom the right to make the election is denied" (App. 31, 32).

* * *

Clearly, the original LIFO regulation did not accord retail method taxpayers the right to elect LIFO. To be sure, those taxpayers had a right to litigate the correctness of that regulation (the course chosen in *Hutzler*). But to allow this does not answer the questions: (i) when did the right of retail method taxpayers to elect LIFO, pursuant to a regulation issued by the Commissioner, first come into being, and (ii) does the right to litigate the validity of a regulation satisfy the Congressional mandate that retail method taxpayers be accorded the right to elect LIFO under a regulation to be prescribed by the Commissioner. Immanent in the answers to those questions are answers to questions of critical importance in the fields of federal tax law and in administrative law generally.

2. Refusing to recognize the inapplicability of the original LIFO regulation to retail method taxpayers or, alternatively, assuming it sufficient that those taxpayers had a right to challenge that regulation, the Government declares each case relied upon in the petition as in conflict with the decision below to be either not "in point", without "conceivable relevance" or only "remotely in point".

(a) The Government bends both *Pictorial Review Co. v. Helvering*, 68 F. 2d 700 (D. C. Cir. 1934), and this case in an effort to destroy the clear parallelism between them. Thus, the Government first attempts to distinguish *Pictorial Review* by urging that here, in contrast to that case, "the 'right of election' was admittedly 'in being' all of the time" (GB 14, fn. 8). That is patent question begging for the Government has unequivocally asserted that

". . . The sole issue in this case is whether [the original LIFO regulation] was applicable to [retail method taxpayers]" (GB 8-9).

The Government also seeks to distinguish *Pictorial Review* by suggesting that, in contrast to the instant case, the original regulation in that case was "valid" (GB 13). To the extent that the Government is implying that the original LIFO regulation was "invalid," it is arguing that that regulation was inapplicable to, and, hence, not binding on, retail method taxpayers. If the Government is using the word "invalid" in the same sense as that word was used by this Court in *Manhattan Co. v. Commissioner*, 297 U. S. 129, it is admitting a conflict between this case and *Manhattan Co.* Unless the Government is arguing that the original LIFO regulation was invalid as to retail method taxpayers, the distinction it perceives between *Pictorial Review* and this case is incomprehensible.

Finally, the Government asserts that the "whole point" of *Pictorial Review* is that the initial regulation there was "binding" on the taxpayer and "*could not* have been successfully challenged" (GB 14, fn. 8)—obviously in contrast to the Government's view that the original LIFO regulation was open to challenge by retail method taxpayers. This distorts the meaning of *Pictorial Review* which describes the Commissioner's initial regulation there as "binding" solely as a bridge to the conclusion that Excella, by failing to challenge the initial regulation, had *not* excluded itself from exercising its right of election following promulgation of an amended regulation curing the Commissioner's misconstruction of the statute. Surely the court of appeals in *Pictorial Review* did not hold that an election regulation which misconstrues a statute cannot be successfully challenged by a taxpayer who wishes to do so—it simply held that a taxpayer has no obligation to do so.

The clear holding of *Pictorial Review* (patently in conflict with the decision below) is that where Congress has accorded a right of election to be exercised pursuant to an administrative regulation, the promulgating administrator

must accord a free choice between the alternatives to be elected and not a choice between litigating the validity of a regulation or being held to have elected by acquiescence. Contrary to the Government and the court below, Congress intended that the LIFO regulation give retail method taxpayers a choice between LIFO and FIFO, not a choice between litigation and FIFO.

(b) The Government implicitly concedes that the decision of this Court in *Manhattan Co.* v. *Commissioner*, 297 U.S. 129, would be relevant and in conflict with the decision below if the original LIFO regulation were invalid with respect to retail method taxpayers (GB 15). Since it is principally by suggesting "invalidity" that the Government seeks to distinguish *Pictorial Review* (GB 14, fn. 8), the Government must concede conflict either with *Manhattan Co.* or with *Pictorial Review*.

(c) The Government admits that *Joseph Horne Co.* v. *United States*, 161 F. Supp. 580 (Ct. Cl. 1958), may be in conflict with the decision below in so far as *Horne* held that the original LIFO regulation had not "prescribed the procedures or standards to be followed by retail method taxpayers in using the LIFO method" (GB 16). The Government's only answer to that conflicting aspect of *Horne* is to suggest that the *Horne* case was incorrectly decided. Whether or not *Horne* was correctly decided, the Government cannot now deny the conflict in view of its own vigorous assertion of conflict on its motion for rehearing in *Horne* (see Pet. 17).*

*The Government attempts to counteract the *Horne* conflict by citing *Kaufmann & Baer Co.* v. *United States*, 133 Ct. Cl. 510, 137 F. Supp. 725 (1956); *cert. denied*, 352 U.S. 835. That the decision below may be in accord with *Kaufmann & Baer* would hardly vitiate the conflict of both of those decisions with *Pictorial Review*, *Manhattan Co.* and *Horne*. In any event, it is obvious from the unique factual situation in *Kaufmann & Baer* (GB 15) that that case should not be dispositive of the claims of the vast majority of retail method taxpayers.

3. The Government concedes, subject to a quibble over the dollar volume of claims thus far actually filed by retail method taxpayers, that on the decision in this case hinges disposition of similar claims involving, in the aggregate, "between $300,000,000 and one billion dollars" (GB 16).

The Government also seems to concede that the net effect of the Commissioner's administration of the LIFO statute, through his original LIFO regulation, has been to deprive the majority of retail method taxpayers of the right to elect LIFO for fiscal years prior to 1948. The Government's boast of the Commissioner's acquiescence in *Hutzler* and his extension since 1948 to retail method taxpayers of the right to elect LIFO for current tax years (GB 17) does not cure the continuing failure of the Commissioner to extend that right to such taxpayers for tax years prior to 1948. Certainly, the fact that the Commissioner may be properly administering the LIFO statute for fiscal years since 1948 does not justify maladministration, with the sanction of the court below, of that statute for all years prior to 1948.

CONCLUSION

The petition for certiorari should be granted.

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